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No. 99-1914

In The

SUPREME COURT OF THE UNITED STATES

TOWN OF NORWOOD, MASSACHUSETTS
Petitioner,

vs.

FEDERAL ENERGY REGULATORY COMMISSION
Respondent,

NEW ENGLAND POWER COMPANY
Intervenor.

On Petition For Writ Of Certiorari To The
United States Court of Appeals For The First Circuit

REPLY TO THE FEDERAL ENERGY REGULATORY COMMISSION'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

The FERC's question presented, Op. Br. at (I), fails to address the key issues posed by Norwood's petition for writ of *certiorari* which relate to whether the FERC, in approving a major utility's voluntary plan to divest its generating facilities conditioned on (1) the payment of billions of dollars by consumers for alleged stranded costs involving those facilities; (2) the setting of fixed prices for up to twelve years for standard offer wholesale power in New England not based on cost of service or actual market prices; and (3) the filing for stranded costs as to non-affiliates twice as high as those paid by affiliates and denial of any standard offer service to non-affiliates, is in conflict with FERC's authority under the Federal Power Act, and Order 888 "intended to favor the development of a competitive generation market, so that the efficiencies of the new marketplace will be available to customers in the form of lower costs for electricity. . .to eliminate undue discrimination,"[1] as well as the Court's *Mobile-Sierra* doctrine,[2] the filed rate doctrine of *Arkansas-Louisiana Gas v. Hall*,[3] and the FERC's obligation confirmed by the D.C. Circuit in *Transmission Access Policy Study Group v. FERC* (June 30, 2000)[4] to provide an evidentiary hearing as a condition precedent to approving any stranded costs against customers.

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[1] Order No. 888-A, 62 Fed. Reg. 12274 (1997), *FERC Regulations Preambles*, ¶31,048 at 30,203 (1997).

[2] *United Gas Pipeline Co. v. Mobile Gas Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

[3] 453 U.S., 571 (1981).

[4] *Transmission Access Policy Study Group , et al. v. FERC*, 2000 U.S. App. LEXIS 15362 *75.

Finally, the question presented by FERC errs in stating that Norwood was allowed the option of terminating its power contract early for payment of a CTC when, in fact, Norwood had no such option.

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COUNTERSTATEMENT

In the present case, New England Power Co. ("NEP" or "NEPCO"), decided voluntarily to divest its generating facilities. NEP entered into an agreement on September 30,

1996 [1] with its affiliates and U.S. Generating Company, a subsidiary of Pacific Gas & Electric Company, conditioned on the payment of alleged stranded costs (called "contract termination charges" ("CTC")) in the amount of $7.6 billion. The agreement also fixed prices for wholesale standard offer power service to be made available to NEP's distribution company affiliates, Mass Electric and Narragansett, for up to 12 years at prices that were below the wholesale market price in New England for the first four years, which would effectively lock in NEP's retail customers to PG&E. PG&E paid a premium of $500 million for this advantage.

In the initial proceedings involving the filing of the agreement by NEP, the Commission terminated previously ordered evidentiary hearings, 78 FERC ¶61,080 (1997), before any testimony and exhibits were formally filed by the intervenors. Norwood moved to file affidavits of its expert witnesses, Dr. John W. Wilson and Robert Towers, demonstrating that the $7.6 billion in stranded costs (CTC) exceeded the standards established by the Commission in its Order No. 888 for calculating any stranded costs by 42% and, in addition, that the standard offer rates denied to Norwood were anticompetitive. The Commission summarily approved the agreement in a short letter order issued November 26, 1997, denied Norwood's request for a hearing, and made no review of Norwood's evidence. App. 29a; 81 FERC ¶61,281, 62,371 (1997).

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[1] The statement by FERC in opposition that the wholesale standard offer rates were based on prices "set by the Massachusetts and Rhode Island regulatory authorities under their retail restructuring programs", Op. Br. at 5, misstates the facts. The wholesale prices in the agreement filed at FERC controlled the state commissions, who have no authority to determine any wholesale rates. In essence, NEP and PG&E initially fixed the prices.

Subsequently, in a second proceeding, NEP sought limited approval from FERC under Section 203 of the FPA, 16 U.S.C. §824b(b), relating to its divestiture of generation related facilities,[2] termination of Tariff No. 1 service to its affiliates, conversion of Norwood's cost of service contract into a fixed, frozen rate, and denial of any standard offer wholesale service to Norwood.[3] Again, the Commission summarily approved the filing and provided no evidentiary hearing.

Norwood, relying on the clear language of FERC's Regulations precluding any stranded costs on Norwood because it obtained open access in 1983 pursuant to an antitrust decree and order requiring Boston Edison to transmit NEP's power to Norwood, then entered into a new power contract on March 3, 1998 with Northeast Utilities ("NU"). That contract was filed and unilaterally approved by FERC on April 22, 1998 as Norwood's new filed rate and was never appealed by NEP.

NEP, in a third proceeding at FERC, unilaterally filed a change to its old Tariff No. 1 which provided that any non-affiliated customer at its option could terminate service by paying a set stranded cost (CTC) to NEP that was twice as high as the CTC which NEP had agreed to for its affiliates

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[2] The FERC has no jurisdiction under the Federal Power Act to require any public utility subject to its jurisdiction to divest its generating facilities. Section 201 of the Federal Power Act expressly provides that the FERC "shall not have jurisdiction . . . over facilities used for generation of electric energy. . ." 16 U.S.C. §824(b).

[3] In approving NEP's application under Section 203, the Commission admitted that it had accepted the standard offer fixed prices without any review as to whether they were just and reasonable: "Norwood is correct that the rates are not based on USGenNE's costs; however, USGenNE is seeking approval of these rates under its market-based rate proposal." App. 74a; 82 FERC at 61,665.

(calculated to be $78 million for Norwood). This CTC was not filed by NEP prior to Norwood entering into its new contract with NU and was not approved by FERC until after it had approved Norwood's NU contract. Norwood raised legal objections to the new NEP CTC, and, in the alternative, requested an evidentiary hearing based on the fact that Norwood would be paying a stranded cost CTC 100% higher than that approved by FERC for NEP's affiliates, despite the fact that NEP's affiliates were transmission customers subject to stranded cost charges under Order 888, while Norwood was not. The FERC summarily approved NEP's CTC tariff and denied any evidentiary hearing on May 15, 1998, App. 102a-110a, and denied rehearing on August 5, 1998. App. 111a-116a.

FERC counsel's theme throughout its brief is that the CTC amendment gave Norwood an option it did not have previously and, therefore, the *Mobile-Sierra* doctrine, filed rate doctrine under *Arkla*, and Norwood's illegal damages claim do not apply. This argument is incorrect. The amendment may have been an option available to NEP's other bundled nonaffiliated customers, but was not an option available to Norwood as can be seen from the chronology of events.

On March 4, 1998, Norwood notified NEP that it had entered a new power contract with Northeast Utilities (NU) on March 3, 1998 for service to commence April 1, 1998. This new NU contract was approved by FERC on April 22, 1998 as Norwood's new filed rate, which NEP never challenged. Subsequently, on May 15, 1998, FERC approved NEP's CTC amendment (filed March 18, 1998). Thus, Norwood's new filed rate was approved by FERC prior to NEP's CTC, which was not filed by NEP until after Norwood entered its new contract.

ARGUMENT

FERC improperly contends that the decision of the court of appeals below does not conflict with any decision of this Court or any other court of appeals.

1. The court of appeals below erred in ruling that NEP could impose parallel-type "stranded costs" on Norwood expressly not authorized by FERC's Regulations, contrary to the rulings of this Court and many courts of appeals that FERC is bound by its own regulations. *See Chevron U.S.A. v. Natural Res. Def. Council*, 467 U.S. 837, 843-844 (1984); *Williams Natural Gas Co. v. FERC*, 944 F.2d 1320, 1328 (D.C. Cir. 1991). FERC's general Regulations, 18 C.F.R. §35.26, explicitly "establishes the standard that a public utility . . . must satisfy in order to recover stranded costs." App. 123a-124a; emphasis added. Both the court below and FERC conceded that "stranded costs" were involved in NEP's filings. App. 28a, 103a and 10a. FERC admitted before the court below and the court affirmed that Norwood was not subject to any stranded costs under the Regulations. App. 10a. However, the court below approved NEP's CTC filing as to Norwood based on one cite from Order 888 not cited in FERC's decisions below, but advanced by FERC's counsel in their brief, and the statement that Norwood had an option of whether or not to choose the CTC. As shown at ¶4, *infra*, Norwood had no such option. The one authority cited by FERC's counsel adopted by the court from Order 888 and two other cites from Order 888-A now cited by FERC's counsel, never adopted by the FERC or the court below, do not authorize any exemption from FERC's Regulations. [4]

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[4] FERC counsel's first cite of Order 888, 61 Fed. Reg. 21,662, Op. Br. at note 7, was not cited by FERC in its orders below but was by the court below, and misses the mark. This ten line section of

Since neither the FERC nor court below could cite any established rationale or legal authority for the "imposition of stranded costs" against Norwood, there simply was no valid, legal basis for the FERC's summary approval of NEP's filing. The court below's failure to identify any other sources of legal authority, (to justify a plain conflict with FERC's Regulations governing the imposition of stranded costs by any utility), clearly violated precedents of this Court as well as other circuits. *See also, Atchison, Topeka & Santa Fe* and *Distrigas of Massachusetts Corp.*, Pet. 16.

Order 888 addresses the threshold question of whether or not "stranded costs" should be allowed at all if the generating utility voluntarily divested. It did not deal with any hypothesis that "stranded costs" could be collected from a non-transmission dependant customer, contrary to the express mandate of the regulations. FERC counsel's second cite of Order 888-A, 62 Fed Reg. 12,382, Op. Br. at note 7, also not cited by FERC in its orders below but raised by its counsel in its brief to the court of appeals, and never adopted by that court, is applicable to former bundled wholesale requirements customers which Norwood has never been. In addition, it comes from a section of Order 888 titled "Rehearing Requests Seeking Broader Stranded Costs Recovery" where the Commission denied requests to "expand the scope of stranded cost recovery to include situations in which the departing customer does not take unbundled transmission from its former supplier." Order 888-A, 62 Fed. Reg. 12,381. FERC counsel's third cite of Order 888-A, 62 Fed Reg 12,406, not cited by either FERC in its orders or the court below, is clearly irrelevant because it relates to retail-turned-wholesale customers, which has nothing to do with Norwood. In addition, all of the sections for authority to assess stranded costs on Norwood cited by FERC's Orders, FERC's attorneys, and the court of appeals are not applicable to Norwood as they never were a bundled wholesale customer and are not now transmission dependant on NEP. Any attempt to link "stranded costs" to Norwood with a "separate (although parallel) justification" via Order 888 fails. Furthermore, FERC, its attorneys, and the court below have never cited any valid authority under any rule, regulation, or precedent under Section 205 of the FPA for the imposition of any charge of this type as FERC has suggested is possible at Op. Br., footnote 8.

2. FERC admits that the court of appeals' decision below properly held that issues of breach of contract and damages therefore were within the jurisdiction of the courts and agrees that the Commission "neither interpreted petitioner's contract with NEPCO nor determined whether petitioner breached its contract with NEPCO," and that "[t]he Commission's decision does not address the situation of customers breaching their contracts." Op. Br. at 13.

FERC now claims that there is no significant question of contract law or any irreconcilable conflict because the CTC was an option available to Norwood and also because the Commission's decision did not address breach of contract. Op. Br. at 13. The FERC is in error because, as Norwood has shown at ¶4, *infra*, the option did not apply to Norwood. The Commission may claim it did not address breach of contract issues but the court of appeals agrees that any application of the CTC against Norwood (where Norwood had no option) is indistinguishable from breach of contract damages. "The termination charge is certainly a detriment, but, absent a showing that its formula is any worse than contract damages, it merely spells out what would have been the law's remedy if [petitioner] had no option but simply breached the existing contract." Emphasis added. App. 12a.

FERC's back door attempt, without any analysis of the contract or relevant facts involved, to determine breach of contract damages, especially where it admittedly has never determined whether any breach of contract occurred, poses a new, major issue of law warranting this Court's consideration. Pet. 17-18.

3. FERC's arguments that the Commission and court of appeals below did not violate this Court's *Mobile-Sierra* doctrine, Op. Br. at 13-14, fail.

The court of appeals and FERC both agree that the CTC would be a violation of *Mobile-Sierra* if the CTC had not been an option to Norwood, which gave Norwood something it did not have before. Op. Br. at 9 and 14. Whereas, Norwood has conclusively shown that Norwood had no such option, ¶4, *infra*, the CTC was a violation of *Mobile-Sierra.*

In addition, since the CTC purported to require Norwood to pay for electric power that it was not receiving from the Company, this unilateral tariff filing by NEP conflicted with the terms of Norwood's Power Contract which expressly barred any tariff filing by NEP that conflicted with the terms of the Power Contract. Similarly, FERC's conversion of Norwood's cost of service rate under Tariff No. 1, based on FERC's regulated cost of service, to a fixed-rate contract, also conflicted with the plain language of the Power Contract requiring service to Norwood only under "Tariff No. 1." Both of these changes to Norwood's power contract are violations of *Mobile-Sierra*. As FERC notes, "the Commission may not approve filed-for changes to a contract that are inconsistent with existing contractual obligations, absent a finding that such charges are in the public interest." Op. Br. at 14.

4. FERC, in agreement with the court of appeals, argues that because of "the CTC being triggered by the wholesale customer's exercise of a newly-created option -- there is no misapplication of the filed rate doctrine." Op. Br. at 15. Since no such option applied to Norwood, all of Norwood's claims regarding *Arkansas-Hall* and the filed rate doctrine are valid. Pet. Br. at 21-24.

FERC's opposition misconstrues *Arkansas-Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981) ("*Arkla*"), holding that "the Commission itself has no power to alter a rate retroactively." 453 U.S. at 578. At the time that Norwood

entered a new contract for power service with Northeast Utilities on March 4, 1998, NEP had no CTC on file approved by the FERC applicable to Norwood. Furthermore, FERC approved Norwood's new power contract with Northeast Utilities as Norwood's new filed rate on April 22, 1998, without any conditions or restrictions, and NEP never appealed that decision. FERC's subsequent attempt in an order issued May 15, 1998 to impose a new CTC applicable to Norwood under its old Tariff 1 with NEP, "effective March 31, 1998" was an unlawful retroactive ratemaking barred by *Arkla.* [5]

The court of appeals' decision below that "the tariff change governed only future purchases of power or failures to purchase power from NEPCO, and not rates for purchases made by petitioner in the past", Op. Br. at 15, represents a major alteration of the filed rate doctrine, because past costs which would be collected in the future, is a retroactive rate. Clearly, the CTC did not govern any future purchases of power by Norwood from NEP. Conversely, Norwood's "failures to purchase power from NEPCO" had already occurred before NEP's CTC was filed and approved. Furthermore, the FERC concedes that the CTC sought to collect past costs when it states that the CTC was "to reimburse NEPCO for a portion of the costs it had incurred [in the past] in preparing to meet its obligation to provide power to the affiliates over the full time of their long-term contracts." Op. Br. at 5.

5. The court of appeals decision below upholding FERC's summary approval of each of the orders below without

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[5] *See, also, Electrical District No. 1 v. FERC* where the D.C. Circuit held that the filed rate doctrine provided "the necessary predictability" and that "wholesale purchasers of electricity cannot plan their activities unless they know the costs of what they are receiving ..." Pet. 22

granting Norwood an evidentiary hearing, directly conflicts with a recent decision of the court of appeals for the District of Columbia Circuit, *Transmission Access Policy Study Group v. FERC*, 2000 U.S. App. LEXIS 15362 (June 30, 2000). That case holds that only after an evidentiary hearing may the Commission award stranded costs:

> . . . Order 888 awards stranded costs to no one. It does nothing more than establish a mechanism by which utilities may seek to recover stranded costs. To recover stranded costs, a utility must demonstrate its continued expectation of service at an evidentiary hearing. . . . Only after such a hearing may FERC decide whether a utility can recover stranded costs and, if so, how much.

Id. at *75; emphasis added; *cf. Southern California Edison Co. v. FERC*, 172 F.3d 74 (D.C. Cir. 1999). This directly conflicts with the decision of the court of appeals below on an important issue affecting open access in the United States, and warrants review by this Court.

CONCLUSION

For the foregoing reasons, petitioner requests that its petition for writ of *certiorari* be granted.

Respectfully submitted,

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